

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

COMMONWEALTH EDISON COMPANY)	
)	Docket No. 14-0312
)	
Annual Formula Rate Update and Revenue Requirement)	
Reconciliation under Section 16-108.5 of the)	
Public Utilities Act)	

**DIRECT TESTIMONY OF MICHAEL L. BROSCHE
ON BEHALF OF THE
PEOPLE OF THE STATE OF ILLINOIS**

AG Exhibit 1.0

July 1, 2014

DIRECT TESTIMONY OF MICHAEL L. BROSCHE

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I. INTRODUCTION / SUMMARY

1 **Q. Please state your name and business address.**

2 A. My name is Michael L. Brosch. My business address is PO Box 481934, Kansas
3 City, Missouri 64148-1934.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in
7 utility rate and regulation work. The firm's business and my responsibilities are
8 related to the conduct of regulatory projects for utility regulation clients. These
9 services include rate case reviews, cost of service analyses, jurisdictional and class
10 cost allocations, financial studies, rate design analyses, utility reorganization
11 analyses, the design and administration of alternative regulation mechanisms and
12 focused investigations related to utility operations and ratemaking issues.

13 **Q. On whose behalf are you appearing in this proceeding?**

14 A. I am appearing on behalf of the People of the State of Illinois represented by the
15 Attorney General, ("Attorney General" or "AG").

16 **Q. Will you summarize your educational background and professional experience**
17 **in the field of utility regulation?**

18 A. Yes. AG Exhibit No. 1.1 is a summary of my education and professional
19 qualifications. I have testified before utility regulatory agencies in Arizona,
20 Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan,
21 Missouri, New Mexico, Ohio, Oklahoma, Texas, Utah, Washington, and Wisconsin
22 in regulatory proceedings involving electric, gas, telephone, water, sewer, transit,

and steam utilities. A listing of my previous testimonies in utility regulatory proceedings is set forth in AG Exhibit No. 1.2. As noted in this listing, I have testified in several major Illinois proceedings before the Illinois Commerce Commission (“the Commission” or “the ICC”), including multiple cases involving Peoples Gas Light & Coke Company, North Shore Gas Company, Commonwealth Edison Company and the Ameren Illinois Utilities, including the initial, second and third rounds of formula rate case proceedings for ComEd and Ameren Illinois, Docket Nos. 11-0721, 12-0321, , 13-0318, 12-0001, 12-0293 and 13-0301.

Q. What is the purpose of your testimony in this docket?

A. My testimony is responsive to the formula rate and revenue requirement calculations of Commonwealth Edison Company (“ComEd” or “Company”) that are sponsored by various Company witnesses and are summarized in ComEd Exhibit 3.01.¹ My testimony addresses Accumulated Deferred Income Taxes (“ADIT”) that are associated with the formula rate reconciliation balance. I also recommend the disallowance of ComEd Annual Incentive Plan (“AIP”) costs in determining the Company’s revenue requirement for the reasons described in my testimony.

Q. Please summarize the recommendations that are set forth in your testimony.

A. My testimony addresses the Accumulated Deferred Income Taxes (“ADIT”) balance recorded by ComEd’s as a result of formula ratemaking reconciliation calculations. The Commission concluded in ComEd’s 2013 formula rate structure and protocol review, Docket No. 13-0553, that ADIT balances arising from the delayed recovery of reconciliation revenues should not serve as an offset to the

reconciliation balance that accrues interest. In AG Exhibit 2.0, Mr. David Effron provides additional evidence in further support of the recommended ADIT offset in calculating reconciliation interest, while my testimony explains the reasons why, in the absence of such an interest offset, the recorded ADIT balances should be treated as an adjustment reducing rate base in determining ComEd's Delivery Service revenue requirement, consistent with other ADIT balances.

I also propose two adjustments to test year incentive compensation costs in my testimony. I recommend the disallowance of costs associated with the Exelon Annual Incentive Plan ("AIP") because awards under the AIP are subject to and controlled by Exelon's achieved earnings per share. Pursuant to 220 ILCS 5/16-108.5(c)(4)(A),² incentive compensation expense that is based on net income or an affiliate's earnings per share shall not be recoverable in the performance-based formula rate. I also recommend disallowance of the remaining costs of the Exelon Long Term Performance Share Award Program ("LTPSAP") not already removed by ComEd because LTPSAP costs are not directly driven by ComEd performance metrics allowable under the aforementioned statute.

Q. What information have you relied upon in formulating your recommendations?

A. I relied upon ComEd's pre-filed testimony and exhibits in this Docket, as well as the Company's responses to data requests submitted by the Commission Staff and the AG. I have referenced a copy of 220 ILCS 5/16-108.5 of the Public Utilities

¹ ComEd Exhibit 3.01 contains the overall formula rate template calculations and is supported by workpapers contained in ComEd Ex. 3.02 as well as multiple other exhibits.

² I am not an attorney and base this conclusion upon my understanding of the law as well as advice of AG counsel that was provided to me regarding the law. Any legal issues will be addressed by AG counsel in briefs.

Act, which was provided to me by AG counsel. I also rely upon my prior experience with the regulation of public utilities over the past 35 years, including significant experience in Illinois and with alternative forms of regulation for telephone and energy utilities.

Q. Have you prepared any accounting schedules to summarize the adjustments being proposed in your testimony and by Mr. Effron?

A. Yes. AG Exhibit 1.3 is a three page summary of the revenue requirement revisions being proposed in my testimony. It should be noted that Mr. Effron and I have not, with available time and resources, been able to conduct a complete review of all aspects of the Company's filing. As a result, the limited adjustments we are proposing should be viewed as cumulative with the work and recommendations of Commission Staff and other parties' witnesses.

II. RECONCILIATION DEFERRED TAXES.

Q. In the previous ComEd formula rate update proceeding, Docket No. 13-0318, did you recommend ratemaking treatment for a specific element of the Company's recorded Accumulated Deferred Income Tax ("ADIT") balance?

A. Yes. In my prior testimony³ I recommended that the Commission reduce the reconciliation balance to which the interest rate is applied to recognize the Company's actual incremental investment in such balances after the deferral of income taxes is considered. I explained that the incremental actual invested capital associated with reconciliation over- or under-recoveries is directly reduced by

³ Docket No. 13-0318, AG Exhibit 1.0, pages 18-26.

income tax payment deferrals, because income taxes are not paid by the utility until the accrued reconciliation revenues are actually collected by the utility in cash and the taxes become payable. When the cash recovery of reconciliation revenues is delayed, the cash payment of related income taxes is also delayed.

Q. Did the Commission respond to your recommendation in its Final Order in Docket No. 13-0318?

A. No. In its Final Order in Docket No. 13-0318, the Commission stated, “The proposal to consider and change the structure and protocols of ComEd’s formula rate related to the calculation of deferred income taxes on reconciliation balance are beyond the scope of this Section 16-108.5(d) annual update and reconciliation proceeding.” This issue I presented was actually decided in Docket No. 13-0533.⁴

Q. What did the Commission decide with respect to reconciliation related ADIT balances in Docket No. 13-0553, where changes to the formula rate tariffs previously approved in Docket No. 13-3086 were considered?

A. The following statements are set forth in the Commission Analysis and Conclusions discussion of income tax deferrals associated with the reconciliation balance interest calculations:

The Commission disagrees with Staff and ComEd that the language in Section 16-108.5(d)(1) is clear or unambiguous on the subject of the appropriate accounting treatment that should be applied to the over-collection or under-collection balance in a reconciliation proceeding under formula rates. The Commission finds merit in the AG and CCI’s proposal that accumulated deferred income tax, or ADIT should be netted against the reconciliation balance before calculating the interest amount. This concept is consistent with Generally Accepted Accounting Principles, is consistent with standard regulatory practice that matches ADIT elements to the associated assets included in rate base and properly recognizes the cash benefit to the utility that would otherwise have been paid out for income taxes on the amount.

⁴ Order, Docket No. 13-0318, December 18, 2013, page 63.

119 While there may be merit to the AG and CCI's proposal and while there
120 may be some debate as to the plain meaning of the Act, the Commission is troubled
121 by the fact that although Section 16-108.5(d)(1) fails to prohibit such accounting
122 treatment, the converse is also true—it does not appear to require or even reference
123 it. Further, as ComEd points out, where the Act does intend that adjustments be
124 made to an amount of a balance, it has done so specifically, as in the case of
125 projected plant additions which are to be included on a net basis considering
126 updated depreciation reserve and expense, 220 ILCS 5/16-108.5(c)(6), or in the
127 ROE collar calculation where the utility is required to apply a credit or charge that
128 “reflects an amount equal to the value of that portion of the earned rate of return on
129 common equity that is more than 50 basis points higher [or lower] than the rate of
130 return on common equity calculated pursuant to paragraph (3) of this subsection
131 (c)...for the prior rate year, adjusted for taxes.” 220 ILCS 5/16-108.5(c)(5).
132

133 The Commission would note that this is not the first time the clarity of this
134 subsection concerning the reconciliation balance has been called into question and
135 that the legislature has already once amended it. Thus, it is difficult for the
136 Commission to support an interpretation of the Act which reads into it exceptions,
137 limitations, or conditions the legislature did not express. Davis v. Toshiba Machine
138 Co., 186 Ill.2d 181, 184-185 (1999). Considering all the arguments presented
139 regarding the meaning of Section 16-108.5(d)(1), the Commission cannot at this
140 time support the AG and CCI's interpretation. For purposes of this proceeding,
141 ComEd is entitled to the full reconciliation balance with interest calculated at a rate
142 equal to the utility's weighted average cost of capital approved by the Commission
143 for the prior year. 220 ILCS 5/16-108.5(d)(1). In the future, if further arguments
144 from the parties are presented or clarity from the legislature is provided on this
145 topic, the Commission will revisit the issue.⁵
146

147 I am advised by AG counsel that this decision by the Commission has been
148 appealed and remains under review by the Appellate Court.

149 **Q. Is your testimony on this subject intended to provide further arguments with**
150 **regard to the calculation of reconciliation interest on a net-of-income-tax basis?**

151 A. No. I understand that Mr. Effron is providing further information in support of the
152 interest offset ratemaking recognition of reconciliation-related ADIT. Given the
153 decision by the Commission in Docket No. 13-0533 to not offset the ADIT amounts
154 recorded by ComEd in the calculation of reconciliation interest, my testimony
155 explains the alternative ratemaking adjustment that should now be made to

⁵ Order, Docket No. 13-0553, November 26, 2013, page 43.

recognize these ADIT balances as a reduction to rate base in calculating the rate year and reconciliation period revenue requirement. Absent rate base inclusion of these ADIT credit balances to reduce rate base, the Company would retain the entire tax deferral benefit arising from delayed collection of (and delayed taxation of) reconciliation revenues for its shareholders, while charging interest to ratepayers as if no income tax deferral benefit exists.

Q. Why do we care about ADIT balances in determining utility rates?

A Utilities are capital-intensive businesses that invest continuously in newly constructed or acquired assets. These large annual capital investments generate persistently large income tax deductions for bonus/accelerated depreciation and other tax deductions and credits that must be recognized by recording ADIT under Generally Accepted Accounting Practices (“GAAP”) rules.⁶ Rates include income taxes without regard to these deductions, because the requirement for normalization accounting denies ratepayers the immediate income tax deferral benefits resulting from such tax deductions. As a result, ratepayers typically provide the utility with more tax related revenue than the utility pays out, and the utility retains this revenue as accumulated deferred income taxes or ADIT. From a ratemaking perspective, a utility’s persistently large credit ADIT balance caused by its deferred payment of recorded tax expenses included in the revenue requirement represents a significant source of capital to the utility.

ADIT balances represent a form of zero-cost capital to the utility created by the income tax savings permitted under tax laws and regulations that are not

⁶ FASB Accounting Standards Codifications at ASC 740-10-25-2(b) specifies that a deferred tax liability or asset shall be recognized for the estimated future tax effects attributable to temporary differences and carryforwards.

immediately “flowed through” to ratepayers. Regulators typically reduce rate base by the ADIT balances, so as to properly quantify the net amount of investor-supplied capital to support rate base assets. The ICC routinely recognizes ADIT balances as rate base reductions in electric delivery service and other rate proceedings.⁷

Q. What is the result of the Commission’s Final Order in Docket No. 13-0553 with regard to the reconciliation interest calculations that have been approved?

A. ComEd shareholders are being allowed recovery of interest at the utility’s full weighted average cost of capital (“WACC”) on the Regulatory Asset investment associated with the reconciliation balance, with no offset for the related income tax deferral benefits that are recorded as ADIT. However, the ADIT balance clearly exists and should be included in the total ADIT deduction to rate base, consistent with established regulatory accounting.

Q. Has ComEd accounted for the ADIT related to the reconciliation balance?

A. Yes. ComEd has cumulatively recorded \$164.9 million of ADIT, representing the deferred income taxes associated with the Company’s cumulative reconciliation balance as of December 31, 2013.⁸ However, ComEd treats this ADIT balance as if it were non-jurisdictional.

Q. Is ComEd’s treatment of the reconciliation-related ADIT appropriate?

A. No. This ADIT is associated with the distribution-related reconciliation revenue requirement, which will be collected in ComEd’s distribution rates. Further, distribution service ratepayers will provide a full return on this regulatory asset in

⁷ See ComEd Ex. 3.01 at Sch. FR B-1, line 17 and at App 4 as well as ComEd Ex. 3.02 at WP 4.
⁸ The reconciliation balance includes under-recovered revenue requirements from 2012 and 2013, recorded on ComEd’s books as of December 31, 2013.

the form of interest at the WACC. There is no basis to treat reconciliation-related ADIT balances as if they are non-jurisdictional in setting formula delivery service rates. Yet this non-jurisdictional treatment is precisely how ComEd has accounted for its recorded reconciliation-related ADIT balances.

Q. What specifically should be done in this formula rate update proceeding to properly account for reconciliation-related ADIT amounts if the Commission requires ratepayers to provide both the underlying revenues and the interest on the gross reconciliation balance, with no interest offset for ADIT?

A. A very simple adjustment is needed, at Line 98 of ComEd Exhibit 3.02, page 28 (WP 4, page 4). Workpaper 4 sets forth ComEd's detailed accounting for actual recorded Accumulated Deferred Income Taxes as of December 31, 2013. Line 98 on WP 4 shows the Company's ADIT liability for "Regulatory (Asset)/Liab: Distribution Formula Rate" including both Federal and State amounts as well as a Total of \$164.9 million for this ADIT liability. However, the entire amount on line 98 is treated by ComEd as if it is unrelated to the provision of regulated Delivery Service by using a "Non DST" designation. The needed adjustment is a change to ComEd's chosen "Allocator", that is now stated as "Non DST" in column (E), to "DST" with the percentage in column (F) then changed from 0% to 100%. This change results in a correspondingly larger "Total ADIT" balance on line 114 that then flows into ComEd Ex. 3.01 at App 4, line 8 in the "DS Jurisdictional" column (D), and which ultimately flows into Sch FR B-1, line 17 along with other elements of DS Jurisdictional ADIT as a deduction to rate base.

222 **Q. Why are you now recommending a 100 percent DS Jurisdictional treatment of**
223 **ComEd’s recorded ADIT liability associated with “Distribution Formula Rate”**
224 **reconciliation regulatory asset balances?**

225 A. As noted above, in prior ComEd formula rate update proceedings and in Docket No.
226 13-0553, my primary recommendation was that reconciliation-related ADIT
227 balances should be treated as an offset within the reconciliation interest calculation
228 on Schedule FR A-4 of the formula rate template. This primary recommendation
229 would treat reconciliation-related ADIT balances entirely as “DS Jurisdictional” but
230 do so outside of the revenue requirement, by reducing the reconciliation balance on
231 which the calculation of WACC interest is being charged to ratepayers. Given that
232 the Commission has rejected this preferred approach, the appropriate and necessary
233 alternative approach is the rate base offset explained in this testimony.

234 **Q. Does the deferral of income tax expense have the effect of reducing the amount**
235 **of capital investment ComEd is required to actually finance while awaiting**
236 **cash recovery of the reconciliation revenue requirement?**

237 A. Yes. When revenues are under-recovered and reconciliation balances are to be
238 collected from ratepayers in future years, the Company records on its book the
239 following two types of accounting entries:

- 240 • A regulatory asset is created, with the credit side of this entry increasing
241 current revenues to accrue the incremental revenues that are to be recovered
242 in the future, and,
- 243 • An ADIT liability to recognize the obligation to pay future income taxes
244 associated with the regulatory asset when it is collected in cash from
245 ratepayers. The debit side of this entry is to deferred income tax expense, so

as to recognize the non-cash income tax expenses payable in the future on the non-cash accrued revenues that will be collected in the future.

The regulatory asset represents the gross amount of additional revenue that was needed in that year, but was not recovered in cash, and that is subject to collection with interest after reconciliation is performed. The related deferred income tax liability reduces the forgone cash flow, and the incremental capital ComEd has actually invested in the regulatory asset balance, because the accrued reconciliation revenues recorded but not recovered in providing service are also not currently recognized in ComEd's taxable income for income tax purposes.

Q. Can one observe in the Company's FERC Form 1 the recorded Regulatory Asset balances arising from the formula rate reconciliation process, for which cash revenues have not yet been recovered from ratepayers as of December 31, 2013?

A. Yes. Page 232.1 of the Company's FERC Form 1 sets forth amounts captioned, "Under-recovered Distribution Services Costs" in several line items, including an accrual for "2013 Annual Reconciliation" of \$230.0 million, for "2012 Annual Reconciliation" of \$146.875 million and for "2011 Annual Reconciliation" where the unrecovered amount at year-end 2013 was zero dollars. I have included a copy of this page of ComEd's FERC Form 1 report as AG Exhibit 1.4.

Q. Are these Regulatory Asset balances, that represent reconciliation balances not yet recovered from ratepayers, included in the Company's rate base?

A. Not explicitly. A return on ComEd's reconciliation-related Regulatory Asset investment is not being accomplished by directly including the balances in rate base.

269 Instead, under 220 ILCS 5/16-108.5(d)(1)⁹, the Company is allowed recovery of
270 these regulatory asset balances, plus interest at ComEd's WACC, with such interest
271 calculated and added into the recovery charge. Under this approach, ComEd earns a
272 full and compensatory return through a mechanism that is comparable to rate base
273 inclusion, but is driven by very specific formulas within Sch. FR A-4 instead of by
274 adding the recorded Regulatory Asset balances directly into rate base.

275 **Q. Should the recorded ADIT balances at line 98 of ComEd's WP 4 be excluded**
276 **from the calculation of DST formula rates, as ComEd proposes, simply because**
277 **the associated Regulatory Asset balances are not included in the DST Rate**
278 **Base?**

279 A. No. This ADIT balance is associated with the Regulatory Asset: Distribution
280 Formula Rate. It represents the income tax deferral benefit that should be attributed
281 to ratepayers in the same jurisdiction that is "paying" a return on the related
282 Regulatory Asset balance. ComEd delivery service customers are responsible for
283 paying interest at a WACC rate on such balances until they are recovered, which is
284 comparable to rate base inclusion of the balances. Therefore, ComEd delivery
285 service customers should be credited with the related ADIT balances in rate base.¹⁰

286 **Q. Is there any other jurisdiction served by ComEd where the Regulatory Asset:**
287 **Distribution Formula Rate ADIT amounts at line 98 of WP 4 could reasonably**
288 **be credited for ratemaking purposes?**

⁹ Again, I am not an attorney, but AG counsel has provided me with a copy of this portion of the Public Utilities Act.

¹⁰ The Attorney General maintains its recommendation to offset the reconciliation balances earning interest at the WACC with ADIT as its primary position, but recommends rate base inclusion of reconciliation-related ADIT balances as the essential alternative treatment, based upon the Commission's Order in Docket No. 13-0553.

289 A. No. Distribution formula rates have nothing to do with ComEd's FERC-regulated
290 electric transmission services, making any FERC allocation or assignment of these
291 recorded ADIT balances unreasonable. Similarly, the reconciliation-related ADIT
292 amounts have not been recognized in determining charges under any of ComEd's
293 other ICC-approved rates or riders.¹¹ The effect of ComEd's "Non DST" allocation
294 of zero percent of these recorded ADIT balances is to improperly attribute these tax
295 deferral balances to ComEd shareholders, as if Distribution Formula Rate tax
296 impacts are not the direct result of rate regulation in Illinois.

297 **Q. How does ComEd explain its inclusion of none of the ADIT at line 98 of WP 4**
298 **within the Company's rate base?**

299 A. In its response to Staff data request TEE 4.09, the Company stated:
300 Line 98 – Regulatory (Asset)/Liab: Distribution Formula Rate: This DTL relates to
301 the underlying regulatory asset related to the formula rate reconciliations for prior
302 years. As this transaction is a book adjustment and does not create a cash benefit or
303 detriment to ComEd, and does not change the amount collected from or refunded to
304 customers, the related DTL has been excluded from rate base. This decision is
305 consistent with the Orders in ICC Docket Nos. 11-0721, 12-0321, 13-0386, 13-0553
306 and 13-0318.
307
308 I have included a copy of this response within AG Exhibit 1.5.

309 **Q. Is it true that reconciliation-related ADIT , "... is a book adjustment and does**
310 **not create a cash benefit or detriment to ComEd" as asserted in this response?**

311 A. No. The recorded ADIT amount on line 98 represents the additional taxes that will
312 be payable in the future, when reconciliation amounts (that include the full income
313 tax liability) that are owed to ComEd are actually collected in cash from ratepayers

¹¹ For instance, the ADIT captioned Regulatory Asset/Liab: MGP-Environmental Remediation at line 91 are treated as "Non DST" because environmental remediation costs are recovered through Rider ECR that was established in ICC Docket No. 05-0597 to recover such remediation costs. Because of Rider ECR, the underlying liability and related debit ADIT balances are not included in Delivery Service rate base.

and become part of ComEd's taxable income. The deferral of income taxes is very much a cash flow benefit to ComEd whenever it occurs. This is why, in the Company's STATEMENT OF CASH FLOWS in its FERC Form 1 at page 120 all of the increase in "Deferred Income Taxes (Net)" on line 8 is additive in determining "Net Cash Provided by (Used in) Operating Activities" that appears on line 22. I have included a copy of this page of ComEd's FERC Form 1 within AG Exhibit 1.6.

Q. Can you more fully explain why the line 98 ADIT balance represents a cash flow benefit to ComEd that should be attributed to ratepayers?

A. Yes. It is useful to consider the net cash flow benefit ComEd was denied when its cash revenues charged to ratepayers in 2013 were not sufficient to fully fund the Company's delivery service revenue requirement in that year. This is important because reconciliation interest should be charged to ratepayers only as needed to compensate ComEd for the incremental financial investment that was required by the Company's net cash revenue shortfall. If we assume cash revenues were under-recovered by \$230 million in 2013, which is the amount estimated by ComEd that was recorded as both a regulatory asset and an increase to book revenues in its FERC Form 1, the avoided cash payment of income taxes on this accrued book adjustment to revenues was approximately \$95 million.¹² This means that ComEd's actual foregone net cash flow in 2013 was not the full \$230 million of revenues recorded within the regulatory asset, but instead was this amount of foregone revenue reduced by the foregone incremental cash income taxes that were not

¹² ComEd's composite federal and state income tax rate is 41.175%, as set forth in ComEd Ex. 3.01, Sch FR C-4, line 4. Note that the recorded ADIT at line 98 of WP 4 totaling \$164.9 million also includes unrecovered regulatory asset deferred revenue amounts for years prior to 2013.

payable in 2013. Using these values, ComEd was denied net cash flow of \$135 million in 2013 when both the accrued book non-cash revenues and the avoided cash income tax payments on those revenues are considered.

Since ComEd is being allowed interest at WACC on the full unrecovered revenue balance, with no ADIT offset, as a result of the Commission's Final Order in Docket No. 13-0553, the associated ADIT for that year's and prior years' reconciliation balances should be included in rate base. In the event the Commission's Order is ever modified in the future, to recognize ADIT in the interest calculation, the rate base inclusion of reconciliation-related ADIT balances should cease.

Q. Does the fact that ComEd is presently not paying federal income taxes because of its Net Operating Loss ("NOL") carryforward position change your conclusion?

A. No. The Company has included its NOL Deferred Tax Asset ("DTA") within rate base at line 22 of WP 4, increasing rate base by \$36.8 million. This NOL DTA amount is derived from ComEd's stand-alone taxable income, with adjustments for inclusion within the Exelon consolidated group tax return. ComEd's reduced taxable income arising from ComEd's distribution formula ratemaking revenue shortfall in 2013 and reconciliation balance recorded in 2013, which contributed to the ADIT liability on line 98 of WP 4, also had the effect of reducing ComEd and Exelon taxable income and increasing the recorded NOL DTA that increases rate base at line 22.

358 **Q. Does the existence of ComEd's NOL balance in rate base make it more**
359 **important that taxable income reductions caused by delayed recovery of**
360 **reconciliation revenues also be included in rate base?**

361 A. Yes. The Company's jurisdictional allocation of 77.82 percent of the NOL DTA on
362 line 22 makes it essential that the Distribution Formula Rate ADIT liability at line
363 98 also be included in rate base. This is true because ComEd's taxable income in
364 2012 and 2013 would have been higher, and its NOL DTA would have been lower,
365 if not for the delayed recovery of cash revenues for the reconciliation Regulatory
366 Asset that was recorded in 2012 and 2013.¹³

367 **Q. Has ComEd recorded any other Regulatory Assets for which there are**
368 **corresponding ADIT liabilities that the Company has included in rate base,**
369 **and that should be compared to the reconciliation-related ADIT balances that**
370 **are discussed herein?**

371 A. Yes. The reconciliation-related ADIT liabilities of concern are similar to ADIT
372 liabilities that arise from the ratemaking treatment of major storm costs under
373 EIMA. Regulatory Assets are recorded by ComEd for major storm costs that are
374 deferred and amortized with rate recovery over five future years. The similarities to
375 reconciliation accounting include:

¹³ ComEd's allocation of the NOL DTA using a "Net Plant" allocator on line 22 is relatively imprecise, because the NOL is actually driven by all transactions that impact ComEd's and Exelon's taxable income, including depreciation and other plant related transactions as well as all of the other line items listed in WP 4. No attempt has been made to more precisely allocate or assign the NOL DTA to the delivery service jurisdiction due to the lack of time and resources available to the AG and to the Company's provision of income tax returns on a confidential basis, for inspection in its designated data room according to AG 1.08.

- ComEd is allowed to fully recover, on a delayed basis, its actual reconciliation revenue requirement and its incurred major storm restoration expenses.
- A regulatory asset is recorded by ComEd to recognize its entitlement to future revenues,¹⁴ for both storm restoration expenses and reconciliation revenues, but the related income statement accruals have no current period impact upon taxable income.
- When future revenues to recover reconciliation balances or prior years' storm costs are collected in cash, they increase taxable income at that time, reversing a book/tax timing difference for which ADIT balances were previously recorded.
- Both regulatory assets, for reconciliation balances and for storm costs, are allowed to earn a return equal to the WACC. Reconciliation regulatory asset balances earn interest at a rate set equal to the WACC and storm cost regulatory asset balances are directly included in rate base, at ComEd Ex. 3.01, App 5 at line 31, where they earn a WACC return.

However, in spite of the similarities of the circumstances surrounding the regulatory asset accounting and deferred income tax liability recognition for both reconciliation and storm cost delayed recoveries, ComEd is clearly treating the corresponding ADIT balances differently and inconsistently. The Company's WP 4 treats the ADIT arising from delayed cash recovery of storm costs as 100% DST rate base includable, but has treated ADIT arising from delayed cash recovery of reconciliation balances as "Non DST".

399 **Q. Should ADIT balances that are associated with the regulatory assets recorded**
400 **for reconciliations under Distribution Formula Rates be treated the same as**
401 **ADIT balances associated with the regulatory assets for Storm costs?**

402 A. Yes. The ratemaking and income taxation impacts for these book/tax differences
403 are nearly identical. The only difference is that ratepayers pay a return on deferred
404 storm costs via rate base inclusion of the regulatory asset, but pay a return on the
405 deferred reconciliation regulatory asset by adding interest to such balances using an
406 interest rate set equal to the rate base return (WACC).

407 **Q. Please summarize your testimony regarding the credit ADIT balance for the**
408 **Regulatory Asset: Distribution Formula Rate that appears at line 98 of ComEd**
409 **Ex. 3.02, page 24 (WP 4, page 4).**

410 A. Because of the Commission's decision to not recognize offsetting reconciliation-
411 related ADIT balances within reconciliation interest calculations in Docket No. 13-
412 0553, it is necessary and appropriate to fully include these balances within the
413 Company's rate base. The Line 98 Total ADIT amount on ComEd WP 4 is clearly
414 associated 100 percent with delivery service ratemaking as of December 31, 2013
415 and should be included in rate base. The Commission's decisions regarding
416 reconciliation-related ADIT in the Commission's Orders in ICC Docket Nos. 11-
417 0721, 12-0321, 13-0386, 13-0553 and 13-0318 addressed offsetting the
418 reconciliation balance earning interest, but did not consider or address my proposed
419 rate base inclusion of these ADIT balances.

¹⁴ See FERC Form 1, page 232.1, lines 1 through 5, 7 and 8. (AG Exhibit 1.4)

422 **III. INCENTIVE COMPENSATION EXPENSES.**

423
424 **Q. What is the purpose of the adjustment you proposed at AG Exhibit 1.3, page**
425 **2?**

426 A. This adjustment is to exclude all of the test year costs incurred by ComEd in
427 connection with the Exelon Corp. (“Exelon”) Annual Incentive Plan (“AIP”). The
428 Company has proposed rate recovery for all of its recorded 2013 AIP costs, except
429 for a portion of AIP costs charged to ComEd by Exelon Business Services
430 Company (“BSC”),¹⁵ while the adjustment I propose would exclude all of the
431 Exelon AIP costs that are not already removed within ComEd’s ratemaking
432 adjustments.

433 **Q. Why should all of ComEd’s 2013 AIP costs be disallowed?**

434 A. All of ComEd’s 2013 costs for the Exelon Annual Incentive Plan should be
435 excluded because this Plan fails to comply with the provisions within Section 16-
436 108.5(c)(4)(A) of the Act that specify, “Incentive compensation expense that is
437 based on net income or an affiliate's earnings per share shall not be recoverable
438 under the performance based formula rate[.]”¹⁶ ComEd costs incurred under the
439 Exelon AIP fail this requirement because the AIP conditions and modifies incentive
440 payouts based upon Exelon’s Earnings per Share (“EPS”), through the Shareholder
441 Protection Feature of the Exelon AIP, as more fully explained in this section of my
442 testimony.

443 **Q. Who is eligible for participation in the Exelon AIP?**

¹⁵ ComEd Ex. 3.0, pages 41-43 and ComEd Ex. 4.0, pages 30-34. Ms. Brinkman refers to this plan as the ComEd AIP plan, but the plan is applicable to other Exelon subsidiaries in addition to ComEd.

¹⁶ 220 ILCS 5/16-108.5(c)(4)(A).

444 A. The Exelon AIP applies to all ComEd employees and generally to other Exelon and
445 Constellation Energy Group employees in 2013.¹⁷

446 **Q. Is the Exelon AIP the same thing as the “ComEd AIP” that is referenced**
447 **within Ms. Brinkman’s testimony?**

448 A. Yes. When ComEd was asked, in Staff Data Request RWB 7.01, for a more
449 detailed explanation of the Annual Incentive Plan (“AIP”) Shareholder Protection
450 Feature that is referenced in Ms. Brinkman’s testimony (ComEd Ex. 2.0), the
451 Company provided an Attachment 1 that is a copy of the “Exelon 2013 Annual
452 Incentive Program” Information Guide. I have included a copy of this response and
453 Attachment as AG Exhibit 1.7. ComEd is one of the three “Exelon Utilities”
454 appearing in the table at page 4 of the Exelon 2013 AIP Information Guide. That
455 page shows for “ComEd - All Employees” the same array of eight Key Performance
456 Indicators (“KPIs”) that are shown at page 3 of ComEd Exhibit 2.01 for the AIP.

457 **Q. Does the AIP directly tie any portion of awards under the Plan to specific**
458 **operational performance of ComEd?**

459 A. Yes. According to Ms. Brinkman’s testimony, the Exelon AIP for ComEd
460 employees in 2013 had eight operational metrics, two of which related to ComEd
461 cost controls and six related to ComEd operations, as more completely described in
462 her testimony.¹⁸ However, these ComEd-specific metrics, referred to as Key
463 Performance Indicators (“KPIs”), do not ultimately control the payouts under the
464 AIP that are included in ComEd’s asserted revenue requirement.

465 **Q. Is there an over-arching element of the Exelon AIP that governs payouts under**
466 **the plan?**

¹⁷ ComEd Ex. 2.0, 17:349.

467 A. Yes. An overall constraining element of the AIP is its Shareholder Protection
468 Feature, which Ms. Brinkman mentions twice in her testimony without elaboration.
469 She states at line 440, “Overall, ComEd employees exceeded target performance on
470 all but one KPI in 2013, resulting in a calculated AIP payout of 140.4%. However,
471 the payout was limited to 124.4% due to the plan’s Shareholder Protection Feature.”
472 Then again at line 472, Ms. Brinkman states, “ComEd’s 2013 performance relative
473 to its KPIs would have resulted in a payout of 140.4% of target, but due to the
474 Shareholder Protection Feature, the payout was limited to 124.4%. This reduced the
475 total payout by approximately \$8.5 million (non-jurisdictional).”¹⁹

476 **Q. What is the Shareholder Protection Feature of the Exelon AIP?**

477 A. The Shareholder Protection Feature is driven by Exelon’s EPS, as a Corporate
478 Performance Measure that applies to all participants and serves to constrain and
479 define the benefits paid under the Exelon AIP. At page 6 of the Exelon AIP
480 Information Guide, the Shareholder Protection Feature is described, stating, “The
481 AIP includes a feature that limits payout for Operating Company and Business Unit
482 KPIs based upon EPS performance. Under this feature:

- 483 • The composite payout on Operating Company / Business Unit KPIs cannot
484 exceed the EPS performance payout level by more than 20 percentage points.
- 485 • Threshold or higher EPS performance is required for any payout to occur
486 under the AIP.

487 More details regarding the definition of Corporate Performance are specified at
488 page 3 of the Information Guide, where 2013 Exelon EPS values are displayed with
489 Exelon EPS of \$2.22 indicated as the “Threshold” level of EPS and \$2.72 is

¹⁸ *Id.* at 18:361-383.

identified as the “Distinguished” level of Corporate Performance. Page 3 also states, “*Note: Employees participating in the ComEd or BGE KPIs do not have Exelon EPS as a performance measure, but are subject to the EPS shareholder protection feature.*”

Q. How does the Shareholder Protection Feature, using Exelon’s achieved EPS, work together with the Key Performance Indicators (“KPIs”) established for ComEd and the other Exelon Operating Companies and Business Units in determining AIP payouts?

A. Corporate Performance is assessed using Exelon’s EPS as a Corporate KPI, as more fully explained in page 3 of the Exelon AIP Information Guide.²⁰ Operating Company and Business Unit Key Performance Indicators, or KPIs, also are an important component of the Exelon AIP and are defined financial and operational measures used to evaluate the relative financial and operational performance of each Operating Company/Business Unit. Along with Exelon’s EPS, Operating Company/Business Unit KPIs affect the AIP and are called *Funding KPIs*. A brief overview of each Exelon Operating Company/Business Unit’s KPIs is provided at page 4 of the Exelon AIP Information Guide. ComEd’s Operating Company KPIs are described in considerable detail by Ms. Brinkman and other ComEd witnesses.²¹

After KPI performance levels have been measured and weighted within ComEd and each of Exelon’s other Operating Companies and Business Units, the Shareholder Protection Feature is applied. According to page 6 of the Exelon AIP

¹⁹ Id. 21:440-442 and 23:472-475.

²⁰ See AG Exhibit 1.3 at page 3.

²¹ ComEd Ex. 2.0, 18:362-395, 20:423-21:446 and ComEd Ex. 2.01, pages 2-9 See also KPI discussions by ComEd witnesses Garrido, Moy and Donovan within ComEd Ex. 5.0, Ex. 6.0 and Ex. 7.0, respectively.

Information Guide, “The AIP includes a feature that limits payout for Operating Company and Business Unit KPIs based upon EPS performance. Under this feature:

- The composite payout on Operating Company / Business Unit KPIs cannot exceed the EPS performance payout level by more than 20 percentage points.
- Threshold or higher EPS performance is required for any payout to occur under the AIP.”

A “Payout Percentage” table is presented that illustrate how Earnings per Share performance below threshold levels can result in zero payouts for Operating Company and Business Unit KPI measures after the Shareholder Protection Feature is applied.

For an individual participant in the Exelon AIP, an illustrative table appears at page 10 of the Exelon AIP Information Guide that shows each additional step in the calculation of benefits. Step 1C describes the Shareholder Protection Feature (“SPF”) and assumes Exelon’s EPS was at the 100% payout level, causing the weighted payout values for Operating Company KPIs from step 1A to be ratably reduced by a 93.5% SPF multiplier. The remainder of this illustrative calculation applies the hypothetical employee’s individual target incentive opportunity by the appropriate performance multipliers and any applicable Individual Performance Multipliers to determine the final AIP award.

Q. Does the insertion of the Shareholder Protection Feature, based upon Exelon’s achieved EPS, cause the entire Exelon AIP payout amount to be influenced by Exelon’s consolidated EPS results, even if KPI performance within individual

Exelon Operating Companies such as ComEd would yield higher AIP payouts without the Shareholder Protection Feature?

A. Yes. As noted in my previous answer and in the Exelon AIP Information Guide, the composite payout on Operating Company / Business Unit KPIs cannot exceed the Exelon EPS-based performance payout level by more than 20 percentage points. Additionally, threshold levels of Exelon EPS performance must be achieved for any payout to occur under the AIP, even if operational and cost-control KPI performance within ComEd exceeds targeted levels.

What is the adjustment that appears at page 2 of AG Exhibit 1.3?

A. Page 2 sets forth, at lines 2 through 13, the distribution of the AIP cost amounts after all ComEd ratemaking adjustments, as used in the Company's cash working capital calculation. The right side of page 2 shows the derivation of the AG adjustment required to fully remove AIP expense and rate base impacts, which are summed at lines 16 and 21, respectively. The estimated annual revenue requirement effect of removing the AIP from rates is \$43.4 million, as shown on line 29.²²

Has the Commission recently disallowed any ComEd incentive compensation expense because of the same type of concern you describe with respect to the EPS-based Shareholder Protection Feature within the Exelon AIP?

A. Yes. In the most recent ComEd formula rate proceeding, Docket No. 13-0318, ComEd proposed rate recovery of one half of its Executive Long Term Performance

²² This is the amount at the 7.06% rate of return used in setting prospective rates. A modestly smaller impact is produced in Sch FR A-1 REC where the allowed return for the reconciliation year is 7.04% after performance penalties.

555 Share Award Programs (“LTPSAP”). The Commission rejected this proposal,
556 stating in its Final Order:

557 The Commission agrees with CCI, Staff, and the AG that ComEd
558 has failed to meet its burden in demonstrating that any portion of its Long-
559 Term Performance Share Awards Program (“LTPSAP”) satisfies the
560 requirements under Illinois law for inclusion in rates. The EIMA is explicit
561 that incentive compensation based on net income or an affiliate’s earnings
562 per share shall not be recoverable under a performance-based rate. 220 ILCS
563 5/16-108.5(c)(4)(A). The LTPSAP is based on the operational and financial
564 performance of all subsidiaries of Exelon, ComEd’s parent company. These
565 award grants depend on a management committee’s subjective assessment
566 of the performance of all Exelon subsidiaries. There are no direct payout
567 percentages assigned to any of the goals; thus, it cannot be determined what
568 portion of an award is related to ComEd’s operational performance and what
569 weights were given to metrics related to EPS and the operations of other
570 Exelon subsidiaries. ComEd retains the burden of proof, even in the new
571 formula rate structure, to establish the justness and reasonableness of its
572 proposed rates or other charges. *See* 220 ILCS 5/16-108.5(c); 220 ILCS 5/9-
573 201(c). Staff’s attempt to devise an approximation of the portion of
574 LTPSAP attributable to Exelon’s growth and performance (a position
575 abandoned by Staff in its briefs) does not suffice when ComEd has not met
576 its burden to demonstrate what portion of these executive incentive
577 compensation awards are sufficiently related to ComEd’s operational
578 performance to justify inclusion in rates. The EIMA thus prohibits recovery
579 of any arbitrary portion of the LTPSAP and it is disallowed from recovery in
580 its entirety.²³
581

582 **Q. Has Exelon modified its LTPSAP to remove the subjective assessment**
583 **concerns that caused disallowance of these costs in Docket No. 13-0318?**

584 A. Yes. According to Ms. Brinkman, “In 2013, ComEd offered another LTPSAP;
585 however, the plan was changed to directly assign payout percentages to individual
586 goals allowing for greater transparency regarding what portion of an award is
587 related to ComEd’s operational performance and what portion(s) related to EPS
588 metrics and the operations of other Exelon subsidiaries.”²⁴ Because of this change,
589 the Company has removed 86.5 percent of incurred LTPSAP costs for 2013, rather

²³ Order, Docket No. 13-0318, December 18, 2013, page 44.

than the 100 percent resulting from the Order in ICC Docket 13-0318, leaving a residual \$0.4 million of expenses, as shown at ComEd Ex. 3.02, WP 7, page 12 at line 7 within Distribution Expenses for ratemaking purposes.²⁵

Q. Were the changes described by Ms. Brinkman in the 2013 LTPSAP sufficient to remedy the concerns that caused 100 percent disallowance of these expenses in Docket No. 13-0318?

A. No. The changes described by Ms. Brinkman can be observed in ComEd Ex. 2.01, page 17, where the “Metric Weighting” values of 6.7% for CAIDI and another 6.7% for SAIFI are relied upon to support ComEd’s assertion that 13.5 percent of overall LTPSAP expenses should now be recoverable, with the Company’s disallowance adjustment removing the other 86.5 percent. However, these Metric Weighting values are not discretely calculated and applied based upon ComEd performance. Instead, they are combined and equally weighted values for all three Exelon Operating Companies, including Philadelphia Electric, Baltimore Gas & Electric and ComEd. Thus, the relative weight afforded operational performance at ComEd is only one third the weight used in the Company’s modified disallowance. Additionally, the LTPSAP payouts remain subject to an overall Total Shareholder Return (“TSR”) modifier that can increase or decrease overall LTPSAP plan awards by up to 25%, which is a larger overall weighting than has been afforded the CAIDI and SAIFI factors relied upon for ComEd’s proposed 13.5 percent recovery rate. These additional LTPSAP elements are described in the Company’s response to

²⁴ ComEd Ex. 2.0, 27:552-555.

²⁵ See ComEd Ex. 3.02, page 71, WP 7, page 12 at line 7. Gross costs of \$3.5 million were reduced by \$3.0 million in ComEd’s adjustment, prior to jurisdictional allocations.

611 Staff's data request RWB 7.05, which is attached to my testimony as AG Exhibit
612 1.8.

613 **Q. Is there another reason why the LTPSAP expenses should continue to be 100**
614 **percent disallowed?**

615 A. Yes. According to Confidential Attachment 1 to ComEd's response to data request
616 AG 1.17, the weighted average results achieved in 2013 under Exelon's LTPSAP
617 totaled 147.8 percent, but "The Compensation Committee of the Exelon Board of
618 Directors reviewed the results of the LTPSA plan and limited the total payout
619 percentage to 125%."²⁶ This type of subjective, high-level modification of
620 LTPSAP calculated results is not supportive of ComEd's assertion that 13.5 percent
621 of payouts under the plan are now directly tied to ComEd operational performance.
622 I have included a copy of ComEd's response to AG 1.17, along with a redacted
623 copy of Confidential Attachment 1, as AG Exhibit 1.9.

624 **Q. What is the adjustment that appears at page 3 of AG Exhibit 1.3?**

625 A. Page 3 sets forth, at lines 1 through 7, the Company's proposed adjustment to
626 partially remove expenses arising from the 2013 LTPSAP, including ComEd's
627 proposed 86.5% Removal value in column (D). Then, at lines 8 through 14, the
628 same calculations are performed with the disallowance calculated at 100 percent, as
629 approved by the Commission in Docket No. 13-0318. The difference at line 18 is
630 the incremental expense adjustment being proposed by the Attorney General, after
631 including incremental payroll taxes and pension costs associated with the difference
632 shown at line 15.

²⁶ ComEd and the People have mutually agreed that only this portion of Confidential Attachment 1 to AG Data Request 1.17, as discussed herein, can be included in public testimony. With regard to all other respects and proposed uses, Attachment 1 to AG Data Request 1.17 is, and remains, confidential.

633 **Q. What do you recommend with respect to the Exelon AIP and Exelon LTPSAP**
634 **incentive costs that are included in ComEd's asserted revenue requirement?**

635 A. I recommend that all Exelon AIP and Exelon LTPSAP costs recorded in 2013 by
636 ComEd, that are not already removed by the Company's ratemaking adjustments,
637 be excluded in their entirety, because of the Shareholder Protection Feature of the
638 AIP that makes all payouts dependent upon the achievement of targeted and
639 threshold levels of Exelon EPS and because of the small and indirect linkages of
640 ComEd operational performance to any payouts that occur under the modified
641 LTPSAP.

642
643 **IV. CONCLUSION AND RECOMMENDATION.**
644

645 **Q. What is your recommendation regarding the initial revenue requirement to be**
646 **determined for Ameren in this Docket?**

647 A. I recommend that ComEd's delivery service revenue requirement be adjusted to
648 reflect the recommended changes described in my testimony. This amount should
649 be further modified for any Commission-approved ratemaking adjustments
650 proposed by the Staff and other parties, that are not addressed in my or Mr. Effron's
651 Direct Testimony.

652 **Q. Does this conclude your testimony at this time?**

653 A. Yes.